

L 3 COMMUNICATIONS CORP

Form 10-Q

November 02, 2011

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended September 30, 2011**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from                      to**

**Commission file numbers 001-14141 and 333-46983**

**L-3 COMMUNICATIONS HOLDINGS, INC.**

**L-3 COMMUNICATIONS CORPORATION**

**(Exact names of registrants as specified in their charters)**

**Delaware**

**(State or other jurisdiction of  
incorporation or organization)**

**13-3937434 and 13-3937436**

**(I.R.S. Employer  
Identification Nos.)**

**600 Third Avenue, New York, NY**

**(Address of principal executive offices)**

**10016**

**(Zip Code)**

**(212) 697-1111**

**(Registrant's telephone number, including area code)**

Indicate by check mark whether the registrants (1) have filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrants were required to file such reports), and (2) have been subject to such filing requirements for the past 90 days.  Yes     No

Indicate by check mark whether the registrants have submitted electronically and posted on their corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrants were required to submit and post such files).  Yes     No

Indicate by check mark whether the registrants are large accelerated filers, accelerated filers, non-accelerated filers, or smaller reporting companies. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  (Do not check if a smaller reporting company)  Smaller reporting company

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Indicate by check mark whether the registrants are shell companies (as defined in Rule 12b-2 of the Act).  Yes  No

There were 99,863,200 shares of L-3 Communications Holdings, Inc. common stock with a par value of \$0.01 outstanding as of the close of business on October 28, 2011.

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**L-3 COMMUNICATIONS HOLDINGS, INC.  
AND L-3 COMMUNICATIONS CORPORATION**

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For the quarterly period ended September 30, 2011**

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AND L-3 COMMUNICATIONS CORPORATION****CONDENSED CONSOLIDATED BALANCE SHEETS****(in millions, except share data)**

	<b>(Unaudited) September 30, 2011</b>	<b>December 31, 2010</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 538	\$ 607
Billed receivables, net of allowances of \$30 in 2011 and \$34 in 2010	1,188	1,299
Contracts in process	2,783	2,548
Inventories	352	303
Deferred income taxes	116	114
Other current assets	168	207
Total current assets	5,145	5,078
Property, plant and equipment, net	917	923
Goodwill	8,735	8,730
Identifiable intangible assets	428	470
Deferred debt issue costs	34	39
Other assets	194	211
Total assets	\$ 15,453	\$ 15,451
<b>LIABILITIES AND EQUITY</b>		
Current liabilities:		
Current portion of long-term debt	\$	\$ 11
Accounts payable, trade	515	463
Accrued employment costs	698	672
Accrued expenses	577	569
Advance payments and billings in excess of costs incurred	539	580
Income taxes	22	49
Other current liabilities	389	389
Total current liabilities	2,740	2,733
Pension and postretirement benefits	870	943

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Deferred income taxes	418	308
Other liabilities	512	486
Long-term debt	4,126	4,126
Total liabilities	8,666	8,596
Commitments and contingencies (see Note 17)		
Equity:		
L-3 shareholders' equity:		
L-3 Communications Holdings, Inc.'s common stock: \$.01 par value; 300,000,000 shares authorized, 100,880,071 shares outstanding at September 30, 2011 and 108,623,509 shares outstanding at December 31, 2010 (L-3 Communications Corporation's common stock: \$.01 par value, 100 shares authorized, issued and outstanding)	5,000	4,801
L-3 Communications Holdings, Inc.'s treasury stock (at cost), 42,882,514 shares at September 30, 2011 and 32,037,454 shares at December 31, 2010	(3,458)	(2,658)
Retained earnings	5,413	4,877
Accumulated other comprehensive loss	(259)	(256)
Total L-3 shareholders' equity	6,696	6,764
Noncontrolling interests	91	91
Total equity	6,787	6,855
Total liabilities and equity	\$ 15,453	\$ 15,451

See notes to unaudited condensed consolidated financial statements.

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**L-3 COMMUNICATIONS HOLDINGS, INC.  
AND L-3 COMMUNICATIONS CORPORATION**

**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(in millions, except per share data)

	<b>Third Quarter Ended</b>	
	<b>September 30, 2011</b>	<b>September 24, 2010</b>
Net sales:		
Products	\$ 1,856	\$ 1,769
Services	1,931	2,066
Total net sales	3,787	3,835
Cost of sales:		
Products	1,644	1,540
Services	1,737	1,858
Total cost of sales	3,381	3,398
Operating income	406	437
Interest and other income, net	3	3
Interest expense	57	64
Debt retirement charge		5
Income before income taxes	352	371
Provision for income taxes	114	130
Net income	\$ 238	\$ 241
Less: Net income attributable to noncontrolling interests	3	3
Net income attributable to L-3	\$ 235	\$ 238
Less: Net income allocable to participating securities		1
Net income allocable to L-3 Holdings common shareholders	\$ 235	\$ 237
Earnings per share allocable to L-3 Holdings common shareholders:		
Basic	\$ 2.27	\$ 2.08
Diluted	\$ 2.24	\$ 2.07
Cash dividends paid per common share	\$ 0.45	\$ 0.40
L-3 Holdings weighted average common shares outstanding:		
Basic	103.5	114.0

Diluted

104.8

114.7

See notes to unaudited condensed consolidated financial statements.



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**L-3 COMMUNICATIONS HOLDINGS, INC.  
AND L-3 COMMUNICATIONS CORPORATION**

**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(in millions, except per share data)

	<b>Year-to-Date Ended</b>	
	<b>September 30, 2011</b>	<b>September 24, 2010</b>
Net sales:		
Products	\$ 5,473	\$ 5,404
Services	5,681	6,021
Total net sales	11,154	11,425
Cost of sales:		
Products	4,824	4,702
Services	5,130	5,434
Total cost of sales	9,954	10,136
Operating income	1,200	1,289
Interest and other income, net	10	15
Interest expense	176	200
Debt retirement charge	18	18
Income before income taxes	1,016	1,086
Provision for income taxes	325	392
Net income	\$ 691	\$ 694
Less: Net income attributable to noncontrolling interests	9	7
Net income attributable to L-3	\$ 682	\$ 687
Less: Net income allocable to participating securities	2	4
Net income allocable to L-3 Holdings common shareholders	\$ 680	\$ 683
Earnings per share allocable to L-3 Holdings common shareholders:		
Basic	\$ 6.42	\$ 5.93
Diluted	\$ 6.34	\$ 5.89
Cash dividends paid per common share	\$ 1.35	\$ 1.20
L-3 Holdings weighted average common shares outstanding:		
Basic	106.0	115.1

Diluted

107.2

116.0

See notes to unaudited condensed consolidated financial statements.

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**L-3 COMMUNICATIONS HOLDINGS, INC.  
AND L-3 COMMUNICATIONS CORPORATION**

**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF EQUITY  
(in millions, except per share data)**

	L-3 Holdings		Additional	Treasury	Accumulated			Noncontrolling	Total
	Common Stock Shares Outstanding	Par Value			Paid-in Capital	Retained Earnings	Other Comprehensive Income (Loss)		
<b>For the Year-to-Date ended September 30, 2011</b>									
Balance at December 31, 2010	108.6	\$ 1	\$ 4,800	\$ (2,658)	\$ 4,877	\$ (256)	\$ 91	\$ 6,855	
Comprehensive income:									
Net income					682		9	691	
Pension and postretirement benefit plans:									
Amortization of net loss and prior service cost previously recognized, net of income taxes of \$14						22		22	
Foreign currency translation adjustment						(14)		(14)	
Unrealized losses on hedging instruments, net of an income tax benefit of \$7						(11)		(11)	
Total comprehensive income								688	
Distributions to noncontrolling interests							(9)	(9)	
Cash dividends paid on common stock (\$1.35 per share)					(143)			(143)	
Shares issued:									
Employee savings plans	1.6		108					108	
Exercise of stock options	0.4		18					18	
Employee stock purchase plan	0.9		23					23	
			51					51	

Stock-based compensation expense									
Treasury stock purchased	(10.8)			(800)					(800)
Other	0.2		(1)			(3)			(4)
Balance at September 30, 2011	100.9	\$ 1	\$ 4,999	\$ (3,458)	\$ 5,413	\$ (259)	\$ 91	\$ 6,787	
<b>For the Year-to-Date ended September 24, 2010:</b>									
Balance at December 31, 2009	115.4	\$ 1	\$ 4,448	\$ (1,824)	\$ 4,108	\$ (166)	\$ 93	\$ 6,660	
Comprehensive income:									
Net income					687		7	694	
Pension and postretirement benefit plans:									
Net gain arising during the period							3	3	
Amortization of net loss and prior service cost previously recognized, net of income taxes of \$12							19	19	
Foreign currency translation adjustment							(14)	(14)	
Unrealized gains on hedging instruments, net of income taxes of \$2							2	2	
Total comprehensive income								704	
Distributions to noncontrolling interests							(10)	(10)	
Cash dividends paid on common stock (\$1.20 per share)						(139)		(139)	
Shares issued:									
Employee savings plans	1.4		110					110	
Exercise of stock options	1.0		57					57	
Employee stock purchase plan	1.0		32					32	
Stock-based compensation expense			62					62	
Treasury stock purchased	(5.9)			(469)				(469)	
Other	0.2		(5)			(2)		(7)	
Balance at September 24, 2010	113.1	\$ 1	\$ 4,704	\$ (2,293)	\$ 4,654	\$ (156)	\$ 90	\$ 7,000	



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**L-3 COMMUNICATIONS HOLDINGS, INC.  
AND L-3 COMMUNICATIONS CORPORATION**

**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(in millions)**

	<b>Year-to-Date Ended</b>	
	<b>September 30, 2011</b>	<b>September 24, 2010</b>
<b>Operating activities:</b>		
Net income	\$ 691	\$ 694
Depreciation of property, plant and equipment	129	119
Amortization of intangibles and other assets	52	51
Deferred income tax provision	85	47
Stock-based employee compensation expense	51	62
Contributions to employee savings plans in L-3 Holdings common stock	108	110
Amortization of pension and postretirement benefit plans net loss and prior service cost	36	31
Amortization of bond discounts (included in interest expense)	3	18
Amortization of deferred debt issue costs (included in interest expense)	7	9
Non-cash portion of debt retirement charge	5	5
Other non-cash items	1	(6)
<b>Subtotal</b>	<b>1,168</b>	<b>1,140</b>
Changes in operating assets and liabilities, excluding acquired and divested amounts:		
Billed receivables	111	(91)
Contracts in process	(231)	(163)
Inventories	(46)	(19)
Accounts payable, trade	44	12
Accrued employment costs	15	43
Accrued expenses	8	12
Advance payments and billings in excess of costs incurred	(49)	14
Income taxes	50	94
Excess income tax benefits related to share-based payment arrangements	(2)	(6)
Other current liabilities	(2)	(8)
Pension and postretirement benefits	(74)	(34)
All other operating activities	(8)	(10)
<b>Subtotal</b>	<b>(184)</b>	<b>(156)</b>
<b>Net cash from operating activities</b>	<b>984</b>	<b>984</b>
<b>Investing activities:</b>		
Business acquisitions, net of cash acquired	(15)	(710)

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Capital expenditures	(129)	(98)
Dispositions of property, plant and equipment	5	7
Investments in equity investees		(20)
Other investing activities	2	2
Net cash used in investing activities	(137)	(819)
<b>Financing activities:</b>		
Proceeds from sale of senior notes	646	797
Redemption of senior subordinated notes	(650)	(800)
Redemption of CODES	(11)	
Borrowings under revolving credit facility	625	13
Repayment of borrowings under revolving credit facility	(625)	(13)
Common stock repurchased	(800)	(469)
Dividends paid on L-3 Holdings common stock	(143)	(139)
Proceeds from exercises of stock options	21	56
Proceeds from employee stock purchase plan	34	48
Debt issue costs	(7)	(7)
Excess income tax benefits related to share-based payment arrangements	2	6
Other financing activities	(8)	(14)
Net cash used in financing activities	(916)	(522)
Effect of foreign currency exchange rate changes on cash and cash equivalents		(9)
Net decrease in cash and cash equivalents	(69)	(366)
Cash and cash equivalents, beginning of the period	607	1,016
Cash and cash equivalents, end of the period	\$ 538	\$ 650

See notes to unaudited condensed consolidated financial statements.

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**L-3 COMMUNICATIONS HOLDINGS, INC.  
AND L-3 COMMUNICATIONS CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED  
FINANCIAL STATEMENTS**

**1. Description of Business**

L-3 Communications Holdings, Inc. derives all of its operating income and cash flows from its wholly-owned subsidiary, L-3 Communications Corporation (L-3 Communications). L-3 Communications Holdings, Inc. (L-3 Holdings and, together with its subsidiaries, referred to herein as L-3 or the Company) is a prime contractor in Command, Control, Communications, Intelligence, Surveillance and Reconnaissance (C<sup>3</sup>ISR) systems, aircraft modernization and maintenance, and government services. L-3 is also a leading provider of a broad range of electronic systems used on military and commercial platforms. The Company's customers include the United States (U.S.) Department of Defense (DoD) and its prime contractors, U.S. Government intelligence agencies, the U.S. Department of Homeland Security (DHS), U.S. Department of State (DoS), U.S. Department of Justice (DoJ), allied foreign governments, domestic and foreign commercial customers and select other U.S. federal, state and local government agencies.

The Company has the following four segments: (1) C<sup>3</sup>ISR, (2) Government Services, (3) Aircraft Modernization and Maintenance (AM&M), and (4) Electronic Systems. Financial information with respect to each of the Company's segments is included in Note 21. C<sup>3</sup>ISR provides products and services for the global ISR market, C<sup>3</sup> systems, networked communications systems and secure communications products. The Company believes that these products and services are critical elements for a substantial number of major command, control and communication, intelligence gathering and space systems. These products and services are used to connect a variety of airborne, space, ground and sea-based communication systems and are used in the transmission, processing, recording, monitoring, and dissemination functions of these communication systems. Government Services provides a full range of engineering, technical, analytical, information technology (IT), advisory, training, logistics and support services to the DoD, DoS, DoJ, and U.S. Government intelligence agencies and allied foreign governments. AM&M provides modernization, upgrades and sustainment, maintenance and logistics support services for military and various government aircraft and other platforms. The Company sells these services primarily to the DoD, the Canadian Department of Defense and other allied foreign governments. Electronic Systems provides a broad range of products and services, including components, products, subsystems, systems, and related services to military and commercial customers in several niche markets across several business areas, including power & control systems, electro-optic/infrared (EO/IR), microwave, simulation & training, precision engagement, warrior systems, security & detection, propulsion systems, avionics and displays, telemetry & advanced technology, undersea warfare, and marine services.

On July 28, 2011, the Company announced that the Board of Directors approved a plan to spin-off a new, independent government services company that will be publicly traded. The transaction, which is intended to be tax-free to L-3 and its shareholders, is expected to be completed in the first half of 2012 and L-3 shareholders will own 100% of the shares of both L-3 and the new government services company at its completion. The spin-off will not be subject to a shareholder vote.

The completion of the spin-off transaction is subject to certain customary conditions, including filing of required documents with the U.S. Securities and Exchange Commission, receipt of a ruling from the Internal Revenue Service and an opinion of counsel as to the tax-free nature of the transaction. There can be no assurance that any separation transaction will ultimately occur, or if one does occur, its terms or timing.



## **2. Basis of Presentation**

These unaudited condensed consolidated financial statements for the quarterly and year-to-date periods ended September 30, 2011 should be read in conjunction with the audited consolidated financial statements of L-3 Holdings and L-3 Communications included in their Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

The accompanying financial statements comprise the consolidated financial statements of L-3 Holdings and L-3 Communications. L-3 Holdings' only asset is its investment in the common stock of L-3 Communications, its

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**NOTES TO UNAUDITED CONDENSED CONSOLIDATED  
FINANCIAL STATEMENTS (Continued)**

wholly-owned subsidiary, and its only obligations are: (1) the 3% Convertible Contingent Debt Securities (CODES) due 2035, which were issued by L-3 Holdings on July 29, 2005, (2) its guarantee of borrowings under the revolving credit facility of L-3 Communications and (3) its guarantee of other contractual obligations of L-3 Communications and its subsidiaries. L-3 Holdings' obligations relating to the CODES have been jointly, severally, fully and unconditionally guaranteed by L-3 Communications and certain of its wholly-owned domestic subsidiaries. Accordingly, such debt has been reflected as debt of L-3 Communications in its consolidated financial statements in accordance with the accounting standards for pushdown accounting. All issuances of and conversions into L-3 Holdings' equity securities, including grants of stock options, restricted stock, restricted stock units and performance units by L-3 Holdings to employees and directors of L-3 Communications and its subsidiaries, have been reflected in the consolidated financial statements of L-3 Communications. As a result, the consolidated financial positions, results of operations and cash flows of L-3 Holdings and L-3 Communications are substantially the same. See Note 24 for additional information regarding the unaudited financial information of L-3 Communications and its subsidiaries.

The unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X of the SEC. Accordingly, they do not include all of the disclosures required by U.S. GAAP for a complete set of annual audited financial statements. In the opinion of management, all adjustments (consisting of normal and recurring adjustments) considered necessary for a fair presentation of the results for the interim periods presented have been included. The results of operations for the interim periods are not necessarily indicative of results for the full year.

It is the Company's established practice to close its books for the quarters ending March, June and September on the Friday nearest to the end of the calendar quarter. The interim unaudited condensed consolidated financial statements included herein have been prepared and are labeled based on that convention. The Company closes its books for annual periods on December 31 regardless of what day it falls on.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of sales and costs of sales during the reporting period. The most significant of these estimates and assumptions relate to contract revenue, profit and loss recognition, fair values of assets acquired and liabilities assumed in business combinations, market values for inventories reported at lower of cost or market, pension and post-retirement benefit obligations, stock-based employee compensation expense, income taxes, including the valuations of deferred tax assets, litigation reserves and environmental obligations, accrued product warranty costs, and the recoverability, useful lives and valuation of recorded amounts of long-lived assets, identifiable intangible assets and goodwill. Changes in estimates are reflected in the periods during which they become known. Actual amounts will differ from these estimates and could differ materially. For a more complete discussion of these estimates and assumptions, see the Annual Report of L-3 Holdings and L-3 Communications on Form 10-K for the fiscal year ended December 31, 2010.

During the quarter ended April 1, 2011, the Company made certain reclassifications among its C<sup>3</sup>ISR, Government Services, and Electronic Systems segments due to re-alignments in the Company's management and organizational structure. The segment results presented in this quarterly report reflect these reclassifications. See Note 21 for the

prior period sales, operating income, and assets reclassified between segments.

### **3. New Accounting Standards Implemented**

In October 2009, the Financial Accounting Standards Board (FASB) issued a revised accounting standard for revenue arrangements with multiple deliverables. The revision: (1) removed the objective-and-reliable-evidence-

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**L-3 COMMUNICATIONS HOLDINGS, INC.  
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**NOTES TO UNAUDITED CONDENSED CONSOLIDATED  
FINANCIAL STATEMENTS (Continued)**

of-fair-value criterion from the separation criteria used to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting, (2) provided a hierarchy that entities must use to estimate the selling price of each deliverable, (3) eliminated the use of the residual method for allocation, and (4) expanded the ongoing disclosure requirements. The revised accounting standard was effective for the Company beginning on January 1, 2011, and did not have a material impact on the Company's financial position, results of operations or cash flows.

In October 2009, the FASB issued a revised accounting standard for certain revenue arrangements that include software elements. Under the revised standard, tangible products that contain both software and non-software components that work together to deliver a product's essential functionality are excluded from the scope of pre-existing software revenue recognition standards. In addition, hardware components of a tangible product containing software components are excluded from the scope of software revenue recognition standards. The revised accounting standard was effective for the Company beginning on January 1, 2011, and did not have a material impact on the Company's financial position, results of operations or cash flows.

**4. Acquisitions and Dispositions**

All of the business acquisitions discussed below are included in the Company's results of operations from their respective dates of acquisition.

***2011 Business Acquisition and Disposition***

On July 1, 2011, the Company acquired the communications and engineering business of ComHouse Wireless L.P. (ComHouse) for \$13 million, subject to adjustment based on the closing date actual net assets. The acquired business provides L-3 with cellular wave form modulation technology that can be used to counter improvised explosive devices. Based on the preliminary purchase price allocation, the goodwill recognized for this business acquisition was \$9 million and is expected to be deductible for income tax purposes. The goodwill was assigned to the Electronic Systems segment. The ComHouse purchase price allocation is expected to be completed in the fourth quarter of 2011 and will be based on the final purchase price, final appraisals and other analyses of fair values for the acquired assets and assumed liabilities. The Company does not expect that the difference between the preliminary and final purchase price allocation for this acquisition will have a material impact on its results of operations or financial position.

On February 22, 2011, the Company divested Microdyne Corporation (Microdyne), which was within the Electronic Systems segment. The divestiture resulted in an after-tax loss of approximately \$1 million. Microdyne's annual revenues (approximately \$8 million), operating results and net assets were not material for any period presented and, therefore, this divestiture is not reported as a discontinued operation.

***2010 Business Acquisitions and Disposition***

During the year ended December 31, 2010, in separate transactions, the Company acquired Insight Technology Incorporated (Insight), Airborne Technologies, Inc. (ATI), 3Di Technologies (3Di), and FUNA International GmbH (FUNA). In addition, the Company divested the InfraredVision Technology Corporation business. See Note 4 to the

audited consolidated financial statements for the year ended December 31, 2010, included in the Company's Annual Report on Form 10-K for additional information regarding these business acquisitions and the disposition.

As of September 30, 2011, the purchase prices for Insight, ATI and 3Di were finalized and the purchase price allocations were completed with no significant changes from the preliminary amounts. The purchase price for the FUNA business acquisition was finalized as of September 30, 2011 and the purchase price allocation is expected to be completed during the fourth quarter of 2011 and will be based on final appraisals and other analyses of fair values for acquired assets and assumed liabilities. The Company does not expect that the differences between the

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FINANCIAL STATEMENTS (Continued)**

preliminary and final purchase price allocation for the FUNA acquisition will have a material impact on its results of operations or financial position.

***Unaudited Pro Forma Statements of Operations Data***

The following unaudited pro forma Statement of Operations data presents the combined results of the Company and its business acquisitions completed during the year ended December 31, 2010, assuming that the business acquisitions completed during that period had occurred on January 1, 2010.

	<b>Third Quarter Ended September 24, 2010</b>	<b>Year-to-Date Ended September 24, 2010</b>
	<b>(in millions, except per share data)</b>	
Pro forma net sales	\$ 3,862	\$ 11,583
Pro forma net income attributable to L-3	\$ 239	\$ 700
Pro forma diluted earnings per share	\$ 2.07	\$ 6.00

The unaudited pro forma results disclosed in the table above are based on various assumptions and are not necessarily indicative of the results of operations that would have occurred had the Company completed these acquisitions on January 1, 2010.

**5. Contracts in Process**

The components of contracts in process are presented in the table below.

	<b>September 30, 2011</b>	<b>December 31, 2010</b>
	<b>(in millions)</b>	
Unbilled contract receivables, gross	\$ 2,887	\$ 2,769
Unliquidated progress payments	(1,033)	(1,007)
Unbilled contract receivables, net	1,854	1,762
Inventoried contract costs, gross	1,046	882
Unliquidated progress payments	(117)	(96)
Inventoried contract costs, net	929	786
Total contracts in process	\$ 2,783	\$ 2,548

*Inventoried Contract Costs.* In accordance with contract accounting standards, the Company accounts for the portion of its general and administrative (G&A), independent research and development (IRAD) and bid and proposal (B&P) costs that are allowable and reimbursable indirect contract costs under U.S. Government procurement regulations on its U.S. Government contracts (revenue arrangements) as inventoried contract costs. G&A, IRAD and B&P costs are allocated to contracts for which the U.S. Government is the end customer and are charged to costs of sales when sales on the related contracts are recognized. The Company's unallowable portion of it